

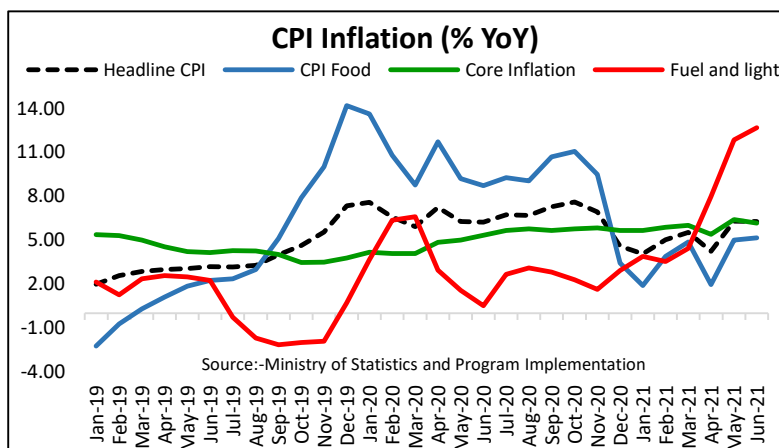


## CPI inflation- June 2021

### Event Update

India's retail inflation based on Consumer Price Index (CPI) for June 2021 came in lower than market expectations; however it continued to remain above the RBI's target range of 2-6%. CPI inflation for June 2021 came in at 6.26% YoY as against 6.30% YoY in May 2021. The markets were expecting the retail inflation to come in at ~6.60% YoY. While Food inflation continued to rise even in June 2021 and came in at 5.15% YoY as against 5.01% YoY in May 2021; Core CPI inflation (ex Food and Fuel, but including 'Transport and communication') witnessed a marginal decline. Core CPI inflation stood at 6.16% YoY in June 2021 as against 6.40% YoY in the previous month. The decline in Core CPI inflation helped the headline in inflation to decline marginally.

The inflation trend in June 2021, within the internal items of the CPI food index was mixed. The deflation in vegetable prices continued to decline and stood at 0.70% YoY in June 2021 as against a deflation of 1.92% YoY in May 2021. On a month on month (MoM) basis, vegetable prices witnessed a rise of 5.07% in June 2021 as against a rise of 2.64% in May 2021. In case of certain essential food items like Egg, 'Milk and products', and 'Oils and fats' inflation witnessed a rise on a YoY basis in June 2021 as against the previous month. However, other food items such as 'Cereals and products', 'Meat and fish', Fruits, and Spices amongst others witnessed a decline in inflation on a YoY basis in June 2021. In case of Core CPI inflation, most of the internals witnessed a decline in inflation on a YoY basis in June 2021 as compared to May 2021, barring items like Clothing, 'Household goods and services' and Education, which witnessed a rise in inflation. Inflation in 'Fuel and light' segment continued to rise for the fourth month in a row and came in at 12.68% YoY in June 2021 as against 11.86% YoY in the previous month.



Though retail inflation surprised the markets by declining marginally in June 2021, it is expected to remain elevated in the near term as the upside pressures on inflation are likely to continue. Rising international crude oil prices, as well as the higher excise duties on fuel domestically, has led to sharp rise in domestic fuel costs over the past several months. Persistently higher fuel costs can eventually translate into higher general prices in the economy. In addition to fuel prices, commodity prices have increased sharply in the last one year as the global economy is recovering from the Covid-19 pandemic. Thus, overall input costs continue to rise, thereby leading to inflationary pressures globally. While localized lockdown like restrictions are being eased gradually, they are not yet fully eased, which is also continuing to impact supply and thus affecting the prices to some extent. Though the onset of the monsoon has been strong, the very recent progress has been muted, which has also affected the Kharif crop sowing to some extent. While monsoon is expected to be good this year as per forecasts, looking at the current progress, uncertainties around Monsoon rains are likely to continue. With the gradual unlocking in many parts of the country the pent up demand could come back strongly. Thus, with expected rise in demand and higher input costs, there is a likelihood that inflation may witness increased pressures from both costs as well demand factors.

### Fixed income view:

Yield of the existing 10-year benchmark G-sec, 5.85% 2030 bond was trading at a level of 6.19% at the time of writing this note, as compared to its previous close of 6.22%. RBI may remain accommodative for the time being, as the economy is still grappling with the impact of the second wave of the pandemic. That said, given the upward pressure on inflation, RBI may have to contemplate on the timing of the normalisation of the accommodative monetary policy and then the reversal of the same. RBI's support in balancing the G-sec demand-supply dynamics has been helping in the orderly movement of the bond yields. Going forward, looking at the bond supply pressure and the increasing expectations of monetary policy normalisation by the RBI, the direction of the bond yields is likely to be a gradual upward movement. Also as and when the RBI explicitly starts the liquidity normalisation process (with inflation likely remaining above the RBI's target band), the short term rates are also likely to inch up. Thus, the entire yield curve is likely to shift upwards. Since the monetary policy normalisation is likely to start with liquidity normalisation, we are likely to witness a gradual flattening of the yield curve to begin with.

**Fixed Income Mutual Fund Strategy:** - Thus, from fixed income investment strategy perspective, currently investors should look at Arbitrage Funds for a horizon of 3 months and above. Investors who would like to lock in current available yields and are not comfortable with volatility, can look at relatively longer tenor Fixed Maturity Plan (FMPs). Investors with an investment horizon of 12 months and above can look at Short Duration

**Funds, Corporate Bond Funds and Banking and PSU Funds. Whereas, for a horizon of upto 3 months investors can consider Overnight Funds and Liquid Funds. Investors should invest in line with their risk profile and product suitability.**

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